

Letter of Findings: 04-20110559
Gross Retail Tax
For the Years 2008, 2009, and 2010

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ISSUE

I. Storage Tank – Gross Retail Tax.

Authority: IC § 6-2.5-1-1 et seq.; IC § 6-2.5-5-3(b); IC § 6-8.1-5-1(c); General Motors Corp. v. Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); Indiana Dept. of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); Indiana Dept. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983); Mumma Bros. Drilling Co. v. Dept. of Revenue, 411 N.E.2d 676 (Ind. Ct. App. 1980); Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); [45 IAC 2.2-5-8\(c\)](#); [45 IAC 2.2-5-8\(d\)](#); [45 IAC 2.2-5-8\(e\)\(3\)](#); [45 IAC 2.2-5-9\(k\)](#).

Taxpayer argues that its purchases of storages *[sic]* tanks were not subject to sales/use tax because the storage tanks are an integral part of Taxpayer's manufacturing process.

STATEMENT OF FACTS

Taxpayer is an Indiana manufacturer and supplier of asphalt products. The Indiana Department of Revenue conducted an audit review of Taxpayer's business records and determined that Taxpayer owed additional sales/use tax. Taxpayer disagreed with a portion of the assessment and submitted a protest to that effect. An administrative hearing was conducted by phone during which Taxpayer's representative explained the basis for the protest. This Letter of Findings results.

I. Storage Tank – Gross Retail Tax.

DISCUSSION

Taxpayer purchased storage tanks. For purposes of this Letter of Findings, this first set of tanks is hereinafter referred to as "Holding Tanks." The Holding Tanks store Taxpayer's asphalt product received upon delivery by truck from Taxpayer's suppliers. The Holding Tanks are heated to maintain the raw product's desired viscosity. While in the Holding Tanks, Taxpayer adds an emulsifier to the product. The emulsifier makes it possible to add water to the product and for this water to fully combine with the product.

After the emulsifier is added, the product is transferred to a "mixing tank." Taxpayer then adds clay and heated water. Afterwards, the product is transferred to a third tank where it is ready to be sold to Taxpayer's customers.

The audit found that the "mixing tank" was the "first step in the manufacturing process." The audit concluded that the "Holding Tanks" were "storage equipment" and were not exempt from sales/use tax. Taxpayer disagrees on the ground that the "Holding Tanks" constitute the first step in the production of Taxpayer's customer-ready asphalt products.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

In applying any tax exemption such as that sought by Taxpayer, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." Indiana Dept. of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). A statute which provides a tax exemption, however is strictly construed against the taxpayer. Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." Id. at 100-101.

In Indiana, a sales tax is imposed on retail transactions, and a complementary use tax is imposed on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-1-1 et seq. In this instance, Taxpayer relies on the tax exemption found at IC § 6-2.5-5-3(b). That particular exemption states that: "Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property." (Emphasis added). It is Taxpayer's contention that the "Holding Tanks" fall within the definition of "direct use" as provided in [45 IAC 2.2-5-8\(c\)](#). That regulation reads as follows:

The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being

produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

Taxpayer points to [45 IAC 2.2-5-8\(d\)](#) as supporting its argument that the "Holding Tanks" are within Taxpayer's production process.

"Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

The Department's regulation, [45 IAC 2.2-5-9\(k\)](#) defines the boundaries of the "production process" as follows:

"Direct production, manufacture, fabrication, assembly, or finishing of tangible personal property" is performance as a business of an integrated series of operations which places tangible personal property in a form, composition, or character different from that in which it was acquired. The change in form, composition, or character must be a substantial change, and it must result in a transformation of property into a different production having a distinctive name, character, and use. Operations such as compounding, fabricating, or assembling are illustrative of the types of operations which may qualify under this definition.

The manufacturing exemption, "fairly read, is meant to exempt capital equipment that meets the 'double direct' test." *Mumma Bros. Drilling Co. v. Dept. of Revenue*, 411 N.E.2d 676, 678 (Ind. Ct. App. 1980). The court has held that capital equipment "in order to be exempt, (1) must be directly used by the purchaser and (2) be used in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining or finishing of tangible personal property." *Indiana Dept. of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520, 525 (Ind. 1983) (Emphasis added). "[T]he test for directness requires the equipment to have an 'immediate link with the product being produced.'" *Id.* Accordingly, the sales tax exemption is applicable to that equipment which meets the "double direct" test and is "essential and integral" to the manufacture of taxpayer's tangible personal property. *General Motors Corp. v. Dept. of State Revenue*, 578 N.E.2d 399, 401 (Ind. Tax Ct. 1991).

In Taxpayer's process of producing customer-ready asphalt products, Taxpayer adds an emulsifier to the raw tar or asphalt contained in the "Holding Tanks." The emulsifier acts upon this raw product in such a way as to allow Taxpayer to combine water with the raw product. In this case, the addition of the emulsifier constitutes the "first operation or activity constituting part of the [Taxpayer's] integrated production process...." [45 IAC 2.2-5-8\(d\)](#). The addition of the emulsifier has "an immediate effect on the article being produced." [45 IAC 2.2-5-8\(c\)](#).

Taxpayer has met its burden of demonstrating that in Taxpayer's particular manufacturing process, with the particular items of equipment involved, and consider the particular product manufactured, Taxpayer acquired the "Holding Tanks" "for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property." IC § 6-2.5-5-3(b) See also [45 IAC 2.2-5-8\(e\)\(3\)](#) ("Storage facilities or containers for materials or items currently undergoing production during the production are deemed temporary storage facilities and containers and are not subject to tax.")

FINDING

Taxpayer's protest is sustained.

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